

TESTIMONY OF MR. MATT WINKLER
EDITOR-IN-CHIEF
BLOOMBERG NEWS
BEFORE THE HOUSE FINANCIAL SERVICES COMMITTEE'S
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT
SPONSORED ENTERPRISES
REGARDING
"ANALYZING THE ANALYSTS II: SOURCES OF ANALYST CONFLICTS"
JULY 31, 2001

MR. CHAIRMAN, I AM DELIGHTED TO HAVE THE OPPORTUNITY TO
APPEAR BEFORE THIS SUBCOMMITTEE AS PART OF YOUR CONTINUING
DISCUSSION ON ANALYZING THE ANALYSTS.

MY NAME IS MATT WINKLER, AND I AM THE EDITOR-IN-CHIEF OF
BLOOMBERG NEWS, A GLOBAL NEWS SERVICE WITH 1,100 REPORTERS AND
EDITORS IN 80 BUREAUS AND 50 COUNTRIES. BLOOMBERG NEWS PRODUCES
MORE THAN 4,000 STORIES DAILY ON THE ECONOMY, COMPANIES,
GOVERNMENTS, FINANCIAL AND COMMODITY MARKETS AS WELL AS SPORTS,
POLITICS AND POLICY. MANY OF THESE STORIES ARE PUBLISHED IN MORE
THAN 350 NEWSPAPERS, INCLUDING THE NEW YORK TIMES, WASHINGTON
POST, LOS ANGELES TIMES, LE MONDE, AND DAILY YOMIURI. SINCE ITS
INCEPTION IN 1990, BLOOMBERG NEWS HAS RECEIVED MORE THAN 50
AWARDS AND CITATIONS FOR THE QUALITY OF ITS JOURNALISM FROM THE

OVERSEAS PRESS CLUB, GERALD LOEB FOUNDATION, SOCIETY OF PROFESSIONAL JOURNALISTS AND THE SOCIETY OF AMERICAN BUSINESS EDITORS AND WRITERS. BLOOMBERG NEWS IS THE MAIN CONTENT PROVIDER FOR BLOOMBERG PRINT AND BROADCAST MEDIA. THESE INCLUDE SEVERAL MAGAZINES, A NEW YORK-BASED RADIO STATION AND NETWORK AND A 24-HOUR TELEVISION NETWORK OPERATING IN THE U.S. AND IN A DOZEN LANGUAGES IN COUNTRIES IN EUROPE, ASIA AND SOUTH AMERICA.

FINANCIAL STORIES ARE BOTH COMPLEX AND CRITICALLY IMPORTANT. AS SOMEONE WHO IS PASSIONATE ABOUT PROVIDING THE PUBLIC WITH THE CONTEXT AND ANALYSIS NECESSARY TO MAKE SOUND DECISIONS, I WANT TO SALUTE THIS COMMITTEE FOR ITS EXTRAORDINARY COMMITMENT TO ENSURING THAT INVESTORS HAVE BROAD ACCESS TO THE HIGHEST-QUALITY INFORMATION ABOUT THE MARKETPLACE. WHEN THIS COMMITTEE GREETED WITH SKEPTICISM EFFORTS TO CREATE A PROPERTY RIGHT IN STOCK MARKET QUOTES, IT IS TAKING A STEP TOWARD ENSURING PUBLIC ACCESS TO INFORMATION. WHEN THIS COMMITTEE EXPLORES THE IMPACT OF REGULATION FAIR DISCLOSURE OR HIGHLIGHTS THE QUESTION OF WHETHER INVESTORS ARE GETTING UNBIASED RESEARCH FROM WALL STREET, YOU ARE TAKING A STEP TOWARD ENSURING PUBLIC ACCESS TO INFORMATION. IN THE INFORMATION AGE, THAT'S NO SMALL ACCOMPLISHMENT.

IT MAY TAKE A BEAR MARKET FOR INVESTORS TO REALIZE THAT MANY

STOCK ANALYSTS HAVE NEVER BEEN ANYTHING MORE THAN FANCY PITCHMEN FOR THE FIRMS THAT SELL SECURITIES. AS LONG AS SHARES WENT UP AS THEY DID IN THE 1990S, ANALYSTS RARELY HAD TO SAY "SELL". IN THEIR LINGO, THE STOCKS WERE NEVER "FULLY PRICED". NOW THAT THE NASDAQ COMPOSITE, THE SYMBOL OF THE GREATEST BULL MARKET EVER, IS DOWN ABOUT 50 PERCENT FROM A YEAR AGO, IT'S EASY TO ATTACK THE ANALYSTS BECAUSE THE FEW OCCASIONS WHEN THEY MIGHT HAVE SAID SELL CAME LONG AFTER THE DAMAGE WAS DONE.

ANALYSTS ALWAYS WILL HAVE A CONFLICT OF INTEREST AS LONG AS THE FIRMS THAT EMPLOY THEM PARTICIPATE IN INITIAL PUBLIC OFFERINGS, ARRANGE STOCK AND BOND SALES AND USE ANALYST RESEARCH TO HELP WIN NEW BUSINESS. IN SUCH CIRCUMSTANCES, IT'S HARD TO FIND ANY ANALYST ON WALL STREET WHO MET A STOCK HE OR SHE DIDN'T LIKE. ANALYSTS ARE PART OF THE SALES TEAM.

IN A BULL MARKET, THEY APPEAR TO BE BRILLIANT. WHEN THE MARKET STUMBLES, THEY'RE SCAPEGOATS FOR EVERY INVESTMENT THAT SOURED. THE CURRENT OUTCRY OVER ANALYSTS' NEGLIGENCE SHOULD REMIND US OF CAPTAIN LOUIS RENAULT IN "CASABLANCA," WHO WAS SHOCKED TO DISCOVER GAMBLING IN RICK'S CAFÉ AS HE COLLECTED HIS WINNINGS.

ANALYST CONFLICTS OF INTEREST ARE A SYMPTOM OF SOMETHING MORE

SINISTER. UNTIL THE SECURITIES AND EXCHANGE COMMISSION LATE LAST YEAR APPROVED REGULATION FD (FAIR DISCLOSURE), PUBLIC COMPANIES ROUTINELY INVITED ANALYSTS AND SOME OF THEIR SHAREHOLDERS TO PRIVATE MEETINGS AS THEY DISCUSSED SALES, PROFITS AND LOSSES.

UNTIL ADOPTION OF REGULATION FD, ANALYSTS WERE PROTECTED UNDER LAW FROM INSIDER TRADING LIABILITY, AND LIABILITY FOR "TIPPING", IF THEY DID NOT HAVE A SPECIAL RELATIONSHIP WITH THE CORPORATE OFFICIALS THAT FED THEM INSIDER INFORMATION -- A MONETARY OR OTHER QUID PRO QUO. THAT PROTECTION WAS DESIGNED TO SHIELD ANALYSTS FROM UNLIMITED RISKS OF LIABILITY FOR ATTEMPTING TO FERRET OUT INFORMATION. IT QUICKLY BECAME PERVERTED HOWEVER, AS ISSUERS FIGURED OUT THEY COULD PUNISH ANALYSTS THAT DID NOT GIVE THEM GOOD RATINGS. THE PUNISHMENT CAME IN THE FORM OF EXCLUSION FROM THE INSIDE INFORMATION GRAVY TRAIN WHICH WAS PROVIDED TO THEIR COMPETITORS. INSIDE INFORMATION WAS THUS JOINED WITH ANALYSTS' RECOMMENDATIONS IN A TROUBLING FORM OF BARTER. IT WAS AS IF A STUDENT COULD PUNISH THE TEACHER FOR GIVING HIM OR HER A BAD GRADE BY WITHHOLDING THE TEACHER'S PAY.

IN SHORT, THIS PRACTICE OF SELECTIVE DISCLOSURE INCREASINGLY MADE THE STOCK MARKET A FINANCIAL "ANIMAL FARM," IN WHICH SOME SHAREHOLDERS WERE MORE EQUAL THAN OTHERS.

THE SLOPED PLAYING FIELD CREATED BY SELECTIVE DISCLOSURE DURING THE 1990S WAS SO COMMON THAT MANY ANALYSTS AND PUBLICLY-TRADED COMPANIES ASSUMED IT WAS THE PRICE OF CAPITALISM. ANALYSTS EQUIPPED WITH INSIDE INFORMATION, THEY ARGUED, WERE NEEDED TO GREASE THE WHEELS OF THE MARKET, EVEN IF THEY COULD TRADE ON THAT INFORMATION BEFORE AUNT BETSEY AND THE REST OF THE COMPANY'S SHAREHOLDERS.

THE SEC DISAGREED BECAUSE IN TOO MANY INSTANCES TRADING IN A COMPANY'S SHARES TURNED OUT TO BE RIGGED, UNDERMINING THE INTEGRITY OF THE STOCK MARKET. AMONG THE MORE EGREGIOUS EXAMPLES:

* ON DEC. 1, 1998, AS WESTERN DIGITAL CORP.'S STOCK SURGED 37 PERCENT ONLY A SELECT GROUP OF INVESTORS AT AN ARIZONA RESORT KNEW WHY THE DISK-DRIVE MAKER WAS HAVING ITS BIGGEST ONE-DAY GAIN EVER. MOST OF THE IRVINE, CALIFORNIA-BASED COMPANY'S 3,700 SHAREHOLDERS COULDN'T EXPLAIN THE SUDDEN SPURT THAT ADDED \$427 MILLION TO WESTERN DIGITAL'S MARKET VALUE IN A FEW HOURS. THEY WEREN'T INVITED TO A ROOM WITH SILK-COVERED WALLS AT THE PHOENICIAN HOTEL IN SCOTTSDALE WHERE THE COMPANY'S CHIEF EXECUTIVE CHARLES HAGGERTY SAID BUSINESS WAS GETTING MUCH BETTER.

* ON NOV. 20, 1998, BARNES & NOBLE INC. SHARES FELL 9.4 PERCENT AFTER THE LARGEST U.S. BOOKSELLER TOLD ANALYSTS ON A

PRIVATE CONFERENCE CALL THAT COSTS TO ADVERTISE THE NEW YORK-BASED COMPANY'S INTERNET BUSINESS WOULD BE GREATER THAN EXPECTED. BARNES & NOBLE SHARES FELL 3 TO 29 IN TRADING OF 3.9 MILLION SHARES, FIVES TIMES THE THREE-MONTH DAILY AVERAGE.

* ON AUG. 12, 1999, DURING THE FIRST 30 MINUTES OF TRADING, MARK TRAUTMAN WATCHED THE MARKET VALUE OF CLOROX CO. DROP BY \$1.8 BILLION, OR 14.5 PERCENT, COSTING HIM \$1 MILLION. THE BLEACH MAKER HAD REPORTED A 6 PERCENT GAIN IN FISCAL-FOURTH QUARTER PROFIT ON A 3 PERCENT DROP IN SALES.

TRAUTMAN, WHO HELPED MANAGE \$65 MILLION AT SHAY ASSET MANAGEMENT, WAS CONVINCED SOMETHING ELSE HAD CAUSED CLOROX STOCK TO DROP 15 POINTS. LITTLE DID HE KNOW THAT CLOROX CHAIRMAN CRAIG SULLIVAN WAS TELLING SOME INVESTORS AND ANALYSTS ON AN INVITATION-ONLY CONFERENCE CALL THAT PROFIT WOULDN'T MEET EXPECTATIONS FOR THE NEXT TWO QUARTERS.

MR. TRAUTMAN, A CLOROX SHAREHOLDER, TOLD BLOOMBERG NEWS "IT'S OUTRAGEOUS THAT I DIDN'T HAVE THE SAME INFORMATION AS SOME OTHERS...I WAS COMPLETELY IN THE DARK."

UNTIL REGULATION FD, SUCH BRIEFINGS AMOUNTED TO LEGALIZED "INSIDER TRADING," ACCORDING TO THE CONSUMER FEDERATION OF

AMERICA, A WASHINGTON-BASED NON-PROFIT ADVOCATE FOR ABOUT 50 MILLION PEOPLE.

WHAT PRECISELY DOES REGULATION FD HAVE TO DO WITH ANALYST CONFLICTS OF INTEREST? EVERYTHING. CONFLICTS AND BIAS BREED IN THE DARK. THE MORE INFORMATION THAT IS AVAILABLE TO THE PUBLIC, THE GREATER OUR COLLECTIVE ABILITY TO ASSESS INDEPENDENTLY WHETHER THE ANALYSIS WE ARE RECEIVING IS POTENTIALLY BIASED.

DOES REGULATION FD "SOLVE" THE PROBLEM OF ANALYST CONFLICTS? OF COURSE NOT. I'D REPEAT, AS LONG AS FIRMS EMPLOY THEM TO PARTICIPATE IN INITIAL PUBLIC OFFERINGS, ARRANGE STOCK AND BOND SALES AND USE ANALYST RESEARCH TO HELP WIN NEW BUSINESS, ANALYSTS ALWAYS WILL HAVE A POTENTIAL CONFLICT OF INTEREST.

ANALYSTS WILL ALWAYS HAVE MORE INFORMATION THAN NON-ANALYSTS. SOME CHECK ON ANALYSTS' BEHAVIOR WILL FLOW FROM INSURING THAT THE PUBLIC AT LEAST HAS AN OPPORTUNITY TO ACCESS MATERIAL NONPUBLIC INFORMATION WHEN AN ISSUER MAKES IT AVAILABLE TO ANALYSTS.

INITIATIVES THAT ENHANCE THE BROAD DISSEMINATION OF INFORMATION TO THE PUBLIC WILL HAVE A SALUTARY IMPACT. JUSTICE BRANDEIS IS REMEMBERED FOR OBSERVING:

PUBLICITY IS JUSTLY COMMENDED AS A REMEDY FOR SOCIAL
AND INDUSTRIAL DISEASES. SUNLIGHT IS SAID TO BE THE
BEST OF DISINFECTANTS; ELECTRIC LIGHT THE MOST
EFFICIENT POLICEMAN.¹

LIKE SEEING A POLICEMAN IN THE REAR VIEW MIRROR OR KNOWING
A CONGRESSIONAL OVERSIGHT COMMITTEE IS LOOKING OVER YOUR
SHOULDER, THE AVAILABILITY OF INFORMATION ENHANCES
ACCOUNTABILITY. THAT SERVES AS A CATALYST THAT SOMETIMES PRODS
BETTER BEHAVIOR, AND THAT'S VERY MUCH IN THE PUBLIC INTEREST.

IN THE CONTEXT OF ANALYSTS AND ISSUERS, FORCING THE ISSUERS
TO REFRAIN FROM SELECTIVE DISCLOSURE OFFERS SOME HOPE THAT THEY
WILL GIVE THE PUBLIC AN EQUAL OPPORTUNITY TO KNOW PERTINENT
DEVELOPMENTS OF THE COMPANY AT THE SAME TIME AS THE ANALYSTS.
THAT PUTS THE ANALYSTS TO THE TASK OF PROVIDING INVESTMENT
ANALYSIS RATHER THAN ACTING AS TIPSTERS. IT FREES THEM OF AT
LEAST SOME OF THE PRESSURES THAT THEY NOW FEEL TO SAY "HOLD FOR
THE LONG TERM" OR SIMILAR CODE WORDS WHEN THEY MEAN "SELL". TO BE
SURE, MANY ANALYSTS WILL HAVE TO CHANGE THEIR APPROACH, BUT THAT
CHANGE SHOULD BRING MORE INTEGRITY TO THEIR ANALYSIS, AND GREAT
BENEFIT TO THE MARKETPLACE.

AGAIN, I COMMEND YOU FOR YOUR WILLINGNESS TO EXPLORE THE
IMPORTANT ISSUE OF ANALYST CONFLICTS.

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1. L. BRANDEIS, *OTHER PEOPLE'S MONEY AND HOW BANKERS USE IT* 62
(1914).